

ILLICIT FINANCIAL FLOWS (IFF) THROUGH COMMODITY TRADE MISPRICING

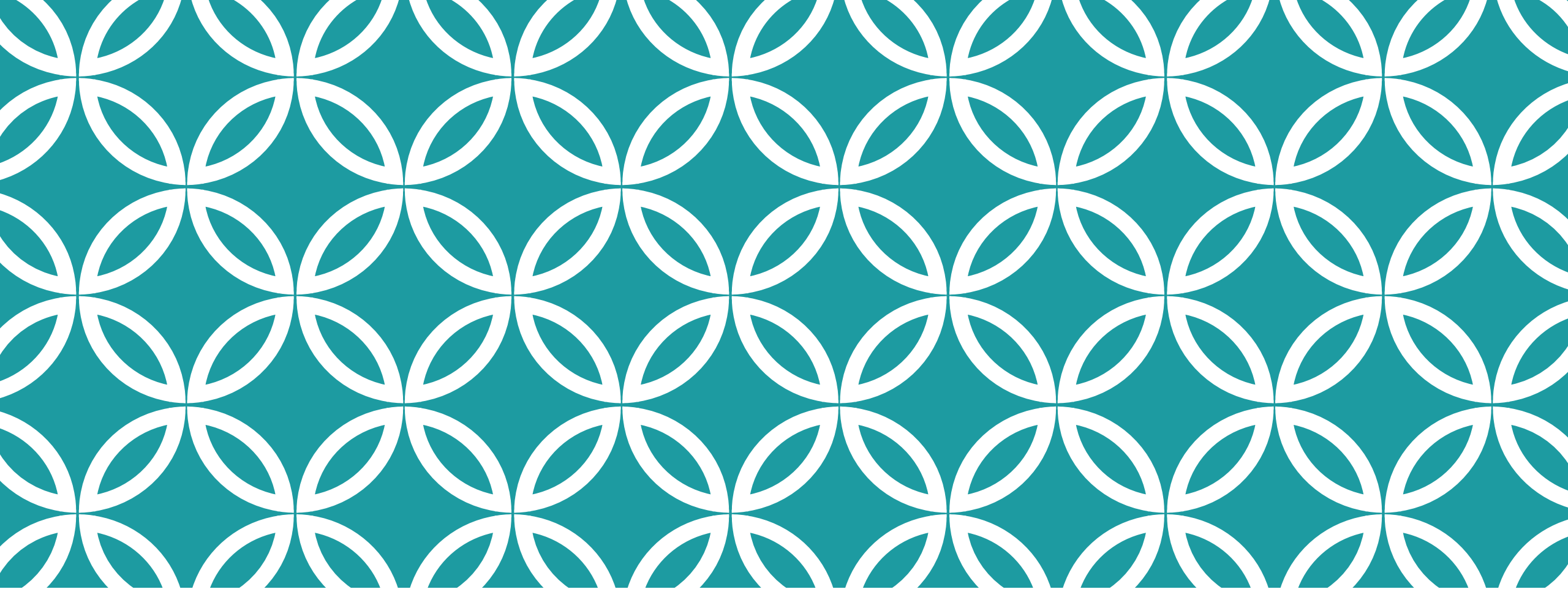
Bücherei, Viktoriarain 12, Bern

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Elisabeth Bürgi Bonanomi
Senior Lecturer in Sustainable Development and Law
Senior Researcher and Policy Advisor PCSD
Centre for Development and Environment (CDE),
University of Bern

Irene Musselli
Senior Researcher and Policy Advisor

Centre for Development and Environment (CDE),
University of Bern



SOME INTRODUCTORY REMARKS

Elisabeth Bürgi Bonanomi

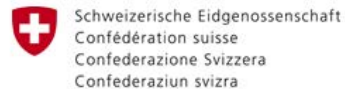
THE PROJECT

Research project **Curbing illicit financial flows from resource-rich developing countries: Improving natural resource governance to finance SDGs**

Funded through the “Swiss Programme for Research on Global Issues for Development” (r4d programme) by the Swiss Agency for Development and Cooperation (SDC) and the Swiss National Science Foundation (SNSF)

<http://www.r4d.ch/modules/employment/curbing-illicit-financial-flows>

<https://curbing-iffs.org/publications/>



Swiss Agency for Development
and Cooperation SDC



THREE BUILDING BLOCKS

Economics (wp1)

- Quantify trade-related IFFs

Law (wp2)

- Legal analysis of IFF concepts, drivers and regulatory responses

Political economy (wp3)

- Political economy analysis focusing on relevant key actors and value chains



WHAT

We are here

Corruption, money laundering

IFF components

Tax-related / other commercial drivers

- Trade mis-invoicing
- Abusive transfer pricing
- Other BEPS practices
- Other mispricing arrangements

Criminal / unlawful

Corruption-related

- Bribery
- Theft-related (embezzlement ...)

Mainly criminal

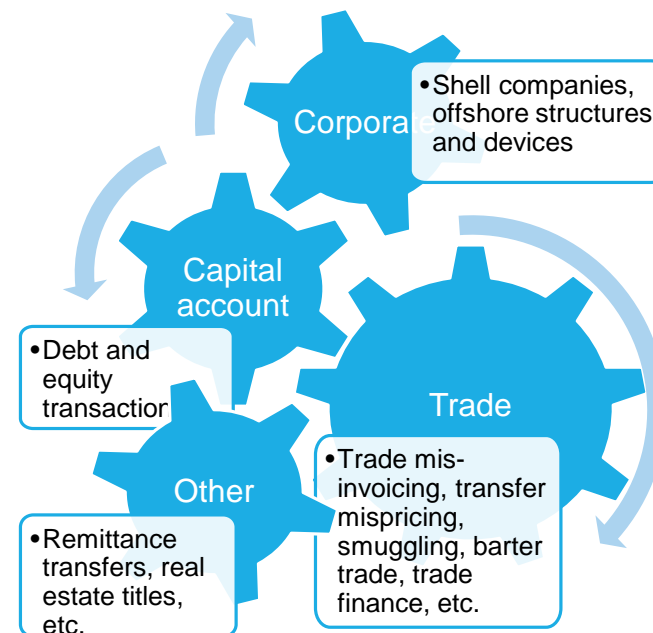
Illegal markets / trade

- **Illegal activities**
 - Drug and human trafficking
 - Maritime piracy
 - Cybercrime ...
- **Illegal trade in otherwise legal goods**
 - Counterfeit and stolen goods
 - Illegal cigarettes / firearms
 - Sanctions busting ...
- **Illegal resource extraction**
 - Oil thefts
 - Conflict commodities
 - Illegal artisanal mining?
 - Illegal fishing and logging
 - Wildlife poaching ...

Terrorism financing

Money-laundering

Channels of IFFs



IFF CONCEPTS

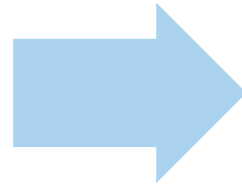
IFF concept

- Challenge legal / illegal distinction
- Criminal law/ administrative law: mostly some illegality
- Anti-avoidance rules & evolving standards
- From Form to Substance: bring in Sustainability Concerns (legality & fairness)

REGULATORY ENABLERS OF PROFIT SHIFTING

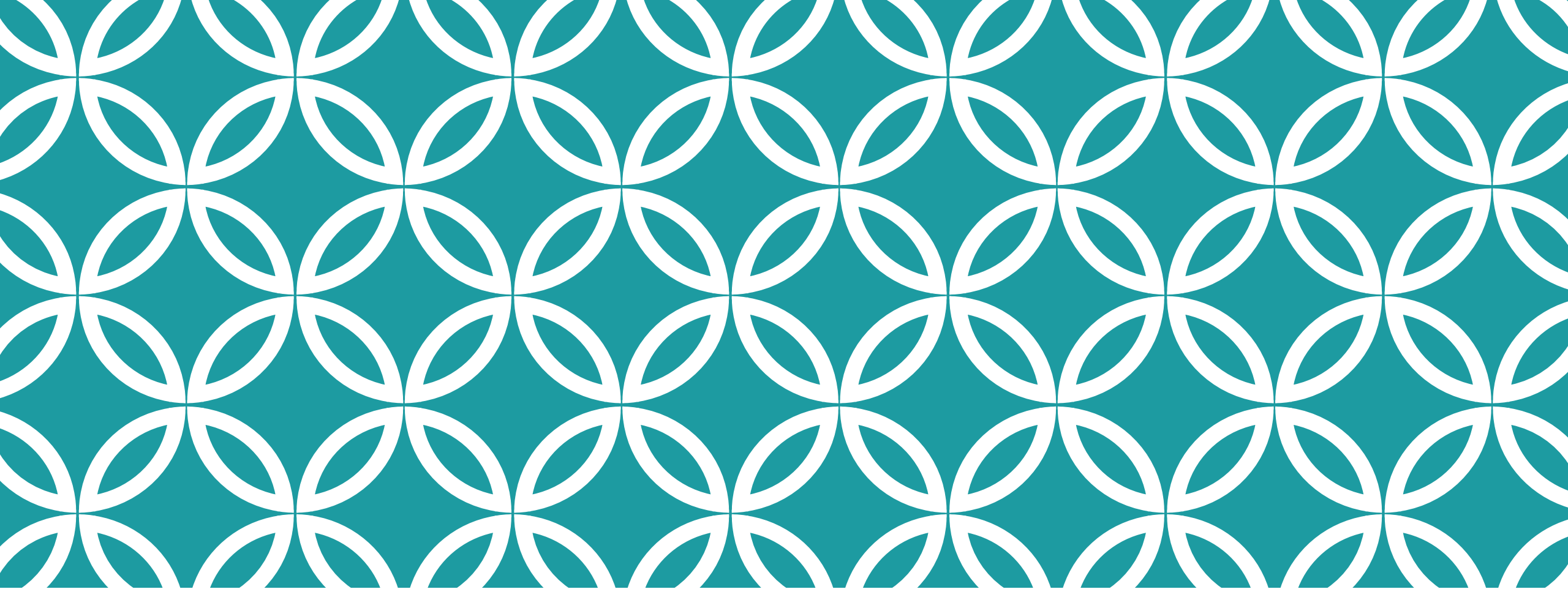
Structural enablers (key tenets of international tax law)

- Constituent entities of a MNE treated as separate legal persons dealing at arm's length
- Mobility of residence (where income from dividends, interests, capital gains, and royalties is taxed)
- Fragmentation



Many technical loopholes and mismatches that MNEs exploit to avoid taxes

- Mismatches in the tax classification of entities and arrangements
- Treaty shopping
- Profit shifting to tax haven subsidiaries
- Excessive interests deductions, etc.



COMMODITY TRADE MISPRICING

Irene Musselli

OUTLINE



What do we mean by 'commodity trade mispricing'



Main regulatory responses



Alternative 'pragmatic' options (unilateral)

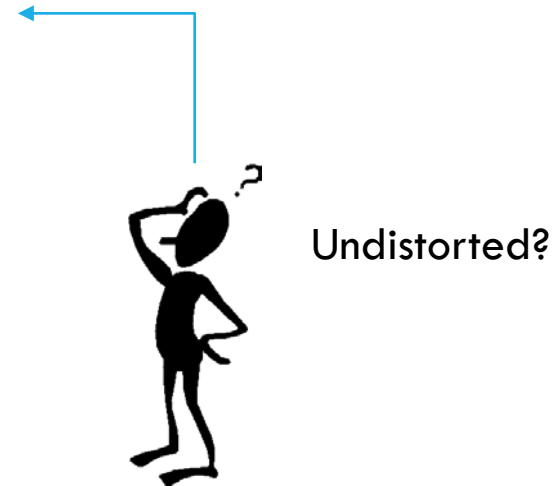


What Switzerland can do

WHAT?

Economic terms ...

- Abnormally priced (deviate from 'market prices')
- Deviation not justified (buyer's functions, assets, risks)



WHAT?

Legal terms...

Defined differently for different legal purposes (customs law, tax law, accounting law...)

Three main 'legal entry points':

- Trade misinvoicing
- Abusive transfer pricing
- 'Unfair' terms

TRADE MISINVOICING

What:

- Exports and/or importers misstate value, quantity, nature of shipment on customs & other trade forms

Example:

- Good-quality coffee shipment intentionally mis-stated in export declarations as low quality and under-valued; mineral content of a concentrate misstated, by counterfeiting the mineral valuation results

Legal status:

- Illegal (often criminal) - customs and tax fraud



Fraudulent, deceit
(misreporting)

ABUSIVE TRANSFER PRICING (ATP)

What:

- Related enterprises sell goods and services to each other at prices that do not approximate the prices that unrelated parties would reach ('arm's length prices')

Example:

- Output side
- Input side

Legal status:

- May trigger tax adjustment (unlawful in administrative/civil law terms)

'UNFAIR' TERMS / 'ABUSE OF POSITION'

What:

- Imbalances in bargaining power between suppliers and buyers

When:

- Purchase price at deep discount to spot prices, not justified (assets, functions, risks)
- No misreporting/ no abusive TP

Legal status:

- May raise issues of unfair terms and abuse of position under contract law and competition law

OUTLINE



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What Switzerland can do

TRANSPARENCY

Tax

- Exchange upon request
- Automatic exchange of bank information
- Exchange of tax rulings ...

Trade

- Supply chain transparency
- Extension to traders of 'Payment to Government' laws

High on the Swiss agenda
(CDE working paper)

OTHER MAINSTREAM OPTIONS

Corporate social responsibility

- Top level commitment to 'fair taxation'
- Proportionate tax risk assessment and due diligence procedures
- Internal procedures for reporting tax wrongdoing
- Awareness raising and training

Swiss emphasis,
except from tax



Transfer pricing law

- Revised OECD Transfer Pricing Guidelines

Customs law enforcement

- Customs-to-Customs and inter-agency cooperation within and between governments
- Importer profiles and risk ratings, fast-tracked clearance for high-compliant operators
- Blockchain technology, container scanning

OUTLINE



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What Switzerland could do



COMMODITY SALES: SIMPLIFIED AND 'PRESCRIPTIVE' PRICING METHODS

Ghana and Laos?

'Sixth-method' (tax self-assessment & audit)

- Taxpayers and tax-administrations refer to quoted prices in determining the fair market value of commodity sales in tax self-assessment and audit

'Administrative pricing' (directly sets the tax value of commodity sales)

- Government uses calculated prices, rather than transaction prices, to determine income-based taxes and royalties due

Legislate price terms in product sales contracts (IISD)

- Fixed prices in long-term supply contracts subject to price floor (costs of building and operating the mine over its expected life + equity return)

PROFIT SHIFTING: SIMPLIFIED PROFIT-BASED METHODS / WHT

Unincorporated
branch operations
of MNEs

'Deemed' net profits

- Multiply the sales proceeds (easy to calculate) by a fixed deemed profit rate
- China, India ... (but also OECD Digital Economy Pillar 1 proposals)

Turnover taxation (gross basis)

- Simple tax on gross-income (no deductions)

Fractional methods

- Affiliate earns a profit margin in proportion to that of the corporate group as a whole ... but can have complex design (Indian's fractional scheme)

Or alternatively, withholding taxes on outbound payments

- Interest, dividends, royalty, etc (see also OECD Digital Economy Pillar 2)



Possibly
'unfair'
features
... but is
profit
shifting
fair?

PROFIT SHIFTING: INTERESTING DEVELOPMENTS (MULTILATERAL)

OECD Work Programme Digital Economy:

- Pillar 1: Some openings (deemed profits & formulary apportionment)
- Pillar 2: ‘Tax back’ if others don’t
- Emphasis on simplification

Promising ... but risks ahead: Potentially far-reaching measures diluted (carve-outs, thresholds and reservations); Diluted reform package traded-off for moratorium on potentially far-reaching unilateral or sub-regional measures

OUTLINE



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What Switzerland can do

SIMPLIFIED METHODS

Policy stance (multilateral negotiations):

- Do not oppose / consider sympathetically developing countries' request for simplified methods

At least as part of a concerted solution that preserves level playing field with other headquarter countries

Technical cooperation:

- Technical support to use simplified methods in tax assessment (SDC & SECO)

TAX TRANSPARENCY

Ease constraints

- Use of information by recipient countries (eg use CbC data as a basis for tax adjustments; use exchange on request information to investigate trade mispricing, etc.)
- Lift reciprocity / spontaneous sharing of data

Grassroots technical assistance

- Peer-to-peer, hands-on training
- Synergies SECO, SDC, FTA
- Possibly domestic rule

QUESTIONS AND DISCUSSION

TP OUTPUT



TP INPUT (SERVICES)

